

Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 PEKING 2635

E.O. 11652: GDS
TAGS: EIND EFIN EAGR ELAB EWTD CH US
SUBJ: CHAIRMAN HUA'S FIRST YEAR ECONOMIC PERFORMANCE

1. SUMMARY. IN THE YEAR SINCE THE OVERTHROW OF THE GANG OF FOUR, THE PRC'S LEADERSHIP HAS MADE CONSIDERABLE PROGRESS IN RESTORING THE NORMAL FUNCTIONING OF THE CHINESE ECONOMY. A YEAR OF DECLINE IN INDUSTRIAL PRODUCTION WAS FINALLY HALTED IN THE SECOND QUARTER OF 1977, AND A 12 PERCENT INCREASE IN GROSS VALUE OF INDUSTRIAL OUTPUT HAS BEEN CLAIMED FOR THE FIRST NINE MONTHS OF 1977 OVER THE CORRESPONDING PERIOD IN 1976. COAL PRODUCTION AND RAIL FREIGHT VOLUME HAVE IMPROVED BUT INADEQUATE COAL AND TRANSPORTATION CONTINUE TO BE IMPEDIMENTS TO THE LONG-TERM GROWTH OF THE ECONOMY. IRON AND STEEL PRODUCTION, THOUGH SOMEWHAT IMPROVED, REMAINS WELL BELOW THE PRC'S STEADILY GROWING REQUIREMENTS. TOTALS FOR 1977 AGRICULTURAL PRODUCTION ARE STILL UNAVAILABLE, BUT GOOD AUTUMN GRAIN HARVEST SHOULD COMPENSATE FOR A SOMEWHAT
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DISAPPOINTING SPRING HARVEST, AND RESULT IN SMALL GAINS IN OVERALL GRAIN PRODUCTION IN 1976.

2. THE RECENTLY CONCLUDED FOURTH PLENUM OF THE FOURTH NPC SHED NEW LIGHT ON PEKING'S ECONOMIC POLICY AND GOALS. AGRICULTURE, POWER, FUEL AND RAW MATERIALS, AND COMMUNICATIONS AND

TRANSPORT WERE SINGLED OUT AS AREAS WHERE IMPROVEMENT IS NEEDED. WAGE INCREASES WERE ANNOUNCED AFFECTING AS MANY AS 46-60 PERCENT OF THE WORKERS, WHICH SHOULD LEAD TO AN INCREASE IN CONSUMER DEMAND. THE FOURTH PLENUM ALSO PROMISED GREATER EFFORTS TO IMPROVE THE AVAILABILITY OF NON-STAPLE FOODS, HOUSING AND CONSUMER GOODS.

3. INCREASING PRODUCTION OF THESE CONSUMER PRODUCTS IS ONE OF THE DIFFICULT DECISIONS FACING THE LEADERSHIP CONCERNING ALLOCATION OF SCARCE INVESTMENT RESOURCES AMONG CONSUMPTION, INVESTMENT FOR INDUSTRY AND AGRICULTURE, DEFENSE AND EXPORTS. AN INCREASE IN GOVERNMENT REVENUES WAS ANNOUNCED FOR THE FIRST NINE MONTHS OF 1977, WHICH WILL HELP TO REDUCE THE INFLATIONARY PRESSURES STEMMING FROM THE WAGE INCREASE. FOR THE LONGER TERM, THE GOALS ARE RATIONALIZING ENTERPRISE MANAGEMENT, IMPROVING PLANNING AND LABOR PRODUCTIVITY, AND UPGRADING THE BANKING AND FINANCIAL SYSTEM. THESE CHANGES, IF IMPLEMENTED SUCCESSFULLY, TOGETHER WITH REFORMS IN EDUCATION AND SCIENCE POLICY, WOULD CONTRIBUTE GREATLY TO LONG-TERM ECONOMIC PERFORMANCE AND BODE WELL FOR GRADUAL STRUCTURAL IMPROVEMENT AND BREAKING THE MAIN BOTTLENECKS FACING
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THE ECONOMY. THESE WILL HAVE LITTLE SHORT-TERM EFFECT, HOWEVER. SIGNIFICANT IMPROVEMENT IN 1978 WILL DEPEND PRIMARILY ON MAINTENANCE OF POLITICAL STABILITY AND ORDER, BETTER ECONOMIC PLANNING, AND GOOD LUCK IN CROPS, WORLD PRICES AND THE MARKET FOR CHINA'S EXPORTS. END SUMMARY.

CURRENT ECONOMIC POLICY

4. HUA KUO-FENG ASSUMED THE CHAIRMANSHIP IN THE MIDST OF AN ECONOMIC RECESSION -- A REAL ONE, IN THE SENSE THAT INDUSTRIAL PRODUCTION DECLINED OVER THREE CONSECUTIVE QUARTERS OF 1976 AND MOST OF THE FIRST QUARTER OF 1977. IN A MAJOR OCTOBER 23 STATEMENT ON THE ECONOMY AT THE RECENT FOURTH PLENUM OF THE FOURTH NPC, YU CHIU-LI, VICE PREMIER AND STATE PLANNING COMMISSION CHAIRMAN, ADMITTED THAT THE PERIOD PRIOR TO MARCH 1977 WAS ONE OF "STAGNATION AND EVEN DECLINE," CONFIRMING OUR IMPRESSION THAT THERE WAS NO INCREASE IN INDUSTRIAL PRODUCTION IN 1976. THE RECESSION WAS HALTED AND THE ECONOMY BEGAN

TO RECOVER BRISKLY BY THE SECOND QUARTER OF 1977,
AND YU ANNOUNCED A 12 PERCENT INCREASE IN GROSS INDUSTRIAL
OUTPUT FOR THE FIRST NINE MONTHS OF THIS YEAR.

5. THE POLICIES ESPOUSED BY THE SO-CALLED GANG
OF FOUR'S ADHERENTS AND THE INDUSTRIAL UNREST
CAUSED BY THEIR FACTIONAL STRUGGLES UNDOUBTEDLY
HAD A MAJOR ROLE IN CAUSING CHINA'S RECESSION.
WHATEVER THEIR REAL ECONOMIC SINS MIGHT HAVE
BEEN, THE GANG OF FOUR HAVE BEEN IDEAL SCAPEGOATS
FOR THE PRESENT LEADERS WHO MISS NO CHANCE TO ASCRIBE CHINA'S
ECONOMIC SHORTCOMINGS TO THE FOUR.

6. THE TOP LEADERSHIP UNDER HUA INCLUDES A NUMBER
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OF COMPETENT MEN IN THE ECONOMIC AREA --
PARTICULARLY LI HSIEN-NIEN YU CHIU-LI, KU MU AND
LI CHIANG. THE EFFECTIVENESS OF THESE
LEADERS HAD BEEN HAMPERED BY RADICAL MAOISM AND
PARALYZING FACTIONAL INFIGHTING. THE REMOVAL
OF THESE POLITICAL OBSTACLES -- TOGETHER WITH
THE RETURN OF THE STRONG ECONOMIC LEADERSHIP OF
TENG HSIAO-PING -- OPENED THE WAY TO A MORE
EFFECTIVE ORGANIZATION OF THE ECONOMY THAN
CHINA HAS SEEN SINCE THE CULTURAL REVOLUTION
OR PERHAPS EVEN SINCE THE GREAT LEAP FORWARD.

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7. YU CHIU-LI'S SPEECH AT THE FOURTH PLENUM CONSTITUTED A REMARKABLY FRANK ASSESSMENT OF THE CURRENT STATE OF THE PRC ECONOMY AND A PROGRAM FOR FUTURE ACTION. YU SINGLED OUT A NUMBER OF ECONOMIC SECTORS WHERE IMPROVEMENT WAS NEEDED: AGRICULTURE, LIGHT INDUSTRY, POWER, RAW MATERIALS (ESPECIALLY COAL AND STEEL), AND COMMUNICATIONS AND TRANSPORT. YU SAID THAT EFFORTS FOR IMPROVEMENT SHOULD CONCENTRATE ON UPGRADING KEY ENTERPRISES AND STRESS SHOULD BE PLACED ON BETTER PLANNING AND MANAGEMENT, INCREASED LABOR PRODUCTIVITY, MORE EFFICIENT USE OF MATERIALS, IMPROVED PRICING, AND BETTER USE OF IMPORTED EQUIPMENT. YU CALLED THE DECADE 1976-1985 "CRUCIAL" TO ACHIEVING CHINESE LONG-TERM DEVELOPMENT GOALS. THIS IS THE PERIOD OF THE CHINESE TEN-YEAR PLAN ANNOUNCED BY CHOU EN-LAI IN 1975, AND IT IS POSSIBLE THAT THE PRC HAS ADJUSTED TO THE FAILURE OF THE FIRST TWO YEARS OF THE CURRENT FIVE-YEAR PLAN BY FALLING BACK ON THE TEN-YEAR PLAN.
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8. A WAGE INCREASE AFFECTING AROUND 46 - 60 PERCENT OF THE INDUSTRIAL WORKERS AND STAFF HAS BEEN ANNOUNCED AND IS GRADUALLY BEING IMPLEMENTED. STATEMENTS BY THE LEADERSHIP LEAVE MANY QUESTIONS UNANSWERED, BUT THE INCREASE APPEARS TO AFFECT MOST WORKERS IN THE LOWEST TWO WAGE CATEGORIES OF INDUSTRIAL WORKERS (PRIMARILY THOSE WITH LONG SERVICE) AS WELL AS OTHER WORKERS AND CADRES WHOSE "CONTRIBUTION TO PRODUCTION" IS EXEMPLARY. FOR THE FIRST GROUP OF WORKERS, THE INCREASE IS PRIMARILY A WELFARE MEASURE AIMED AT RAISING LIVING STANDARDS AND MORALE. FOR THE LATTER GROUP, THE INCREASE IS A ONE-TIME INCENTIVE AWARD, SOMETHING WHICH MAOIST ORTHODOXY DISCOURAGED DURING THE PAST TEN YEARS.

9. INCREASING WAGES IS A POPULAR POLICY, BUT THE EFFECTS COULD BE DISSIPATED IN INFLATION IF THE SUPPLY OF GOODS FOR CONSUMPTION IS NOT INCREASED. YU'S SPEECH CALLED FOR IMPROVING HOUSING, PUBLIC

UTILITIES, AND THE SUPPLY OF NON-STAPLE FOODS IN THE CITIES, AS WELL AS PROVIDING MORE CONSUMER GOODS AND BUILDING MATERIALS FOR HOUSING IN THE COUNTRYSIDE. THIS STATEMENT AND OTHER EVIDENCE SUGGEST THAT THE REGIME INTENDS TO INCREASE STATE RESOURCES ALLOCATED TO CONSUMPTION. STILL, ALLOCATION OF SCARCE INVESTMENT RESOURCES AMONG CONSUMPTION, CAPITAL INVESTMENT IN INDUSTRY AND AGRICULTURE, AND PRODUCTION FOR EXPORT IS A CONTINUING PROBLEM, THE SOLUTION OF WHICH WILL REQUIRE MUCH MORE EFFICIENT PLANNING

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AS WELL AS INCREASES IN PRODUCTION.

10. AT THE NATIONAL BANKING CONFERENCE IN SEPTEMBER, IT WAS ANNOUNCED THAT THE GOVERNMENT ENJOYED A FINANCIAL SURPLUS IN ITS OPERATIONS FOR THE FIRST EIGHT MONTHS OF 1977. AT THE FOURTH PLENUM, YU STATED THAT REVENUES INCREASED 7.2 PERCENT DURING THE FIRST THREE QUARTERS OF 1977 COMPARED TO 1976. THIS INCREASE SEEMS MODEST, CONSIDERING CONDITIONS IN 1976. NEVERTHELESS, THE SURPLUS WAS PROBABLY GRATIFYING TO LDE FINANCIALLY CONSERVATIVE LEADERSHIP, PARTICULARLY IN LIGHT OF LAST YEAR'S SUBSTANTIAL DEFICIT AND THE RECENT CHRONIC FAILURE TO MEET STATE REVENUE TARGETS.

INDUSTRIAL PRODUCTION

11. TOTAL INDUSTRIAL PRODUCTION IN 1976 WAS, BY OUR CALCULATIONS -- MADE ON SEVERAL DIFFERENT SETS OF ASSUMPTIONS -- SLIGHTLY LOWER THAN IN 1975, EVEN THOUGH THE FIRST QUARTER OF 1976 WAS RELATIVELY GOOD. IT WAS NOT UNTIL THE SECOND QUARTER OF 1977 THAT PRODUCTION AGAIN EXCEEDED 1975 LEVELS. ON SEPTEMBER 20, THE PRC CALLED FOR AN ALL-OUT DRIVE FOR 100 DAYS TO IMPROVE THE ECONOMY. BY THE MIDDLE OF OCTOBER, A NUMBER OF INDUSTRIES WERE CLAIMING TO HAVE OVERFULFILLED THEIR PLANS, AND AN INCREASE IN INDUSTRIAL PRODUCTION OF 12 PERCENT OVER THE FIRST THREE QUARTERS OF 1977 OVER THE SAME PERIOD IN 1976 WAS ANNOUNCED. THE DEPRESSED LEVEL OF PRODUCTION IN LATE 1976 SHOULD MAKE YEAR-END PERCENTAGE

GAINS LOOK EVEN HIGHER.

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12. THE PERFORMANCE IN PRIMARY INDUSTRIES REMAINS MIXED. ONE OF THE PRC'S MORE PROMISING ENERGY SOURCES -- NATURAL GAS -- WAS UP 24 PERCENT. OIL PRODUCTION WAS UP 10 PERCENT IN THE FIRST EIGHT MONTHS OF 1977 COMPARED WITH THE SAME 1976 PERIOD, A REASONABLY GOOD PERFORMANCE, BUT ONE WHICH IS DOWN MARGINALLY FROM THE 10.6 PERCENT INCREASE CLAIMED FOR THE FIRST HALF OF 1977 OVER THE FIRST HALF OF 1976. COAL PRODUCTION APPEARS TO BE SATISFACTORY, ALTHOUGH THE ABSENCE THROUGH SEPTEMBER OF ANY PERCENTAGE INCREASE CLAIMS OVER 1976 RAISES QUESTIONS. THE NATION'S LARGEST MINING CENTER, KAILUAN, IS NOT YET PRODUCING AT PRE-EARTHQUAKE LEVELS; HOWEVER, IMPROVEMENT SEEMS TO HAVE BEEN STEADY THIS YEAR. BY THE END OF 1977, NATIONAL COAL PRODUCTION MAY EXCEED THAT OF BOTH 1975 AND 1976.

13. BRINGING ON STREAM SIX OF THE THIRTEEN IMPORTED FERTILIZER PLANTS HAS BEEN PRIMARILY RESPONSIBLE FOR A 27 PERCENT INCREASE IN CHEMICAL FERTILIZER PRODUCTION IN THE FIRST EIGHT MONTHS OVER THE SAME 1976 PERIOD. AN INCREASE OF ONLY 13 PERCENT WAS ANNOUNCED FOR THE FIRST HALF OF 1977 OVER THE FIRST HALF OF 1976, SINCE SOME OF THE PLANTS WERE NOT PRODUCING AT ANYWHERE NEAR CAPACITY. THE LATEST FIGURE POINTS TO IMPROVED PERFORMANCE AND IS ONE OF THE MORE POSITIVE DEVELOPMENTS OF THE YEAR, ALTHOUGH KELLOGG TELLS US THAT PRODUCTION IN THE NEW PLANTS IS STILL FAR BELOW CAPACITY.

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14. LAST YEAR'S SERIOUS PROBLEMS IN THE STEEL INDUSTRY REMAINED UNRESOLVED DURING THE FIRST HALF OF THIS YEAR AT ONE OF CHINA'S LARGEST PLANTS, WUHAN, AND THROUGH AT LEAST THE FIRST QUARTER AT ANSHAN, PAOTOU AND MAANSHAN. THESE PLANTS PRODUCED ABOUT NINE MILLION TONS OF CRUDE STEEL IN 1975. CHINESE CLAIMS THAT IRON AND STEEL PRODUCTION REACHED RECORD MONTHLY HIGHS IN AUGUST, SEPTEMBER AND OCTOBER WOULD SHOW REMARKABLE RECOVERY SINCE EARLY IN THE YEAR. EVEN IF WE ACCEPT THESE CLAIMS, TOTAL PRODUCTION FOR THIS YEAR WILL STILL BE BELOW THE ESTIMATED 26 MILLION TONS ACHIEVED IN 1973. WHILE PRODUCTION IS CREEPING UPWARD IN THE FACE OF A HOST OF PROBLEMS, THE PRC'S STEEL REQUIREMENTS ARE GROWING EVEN FASTER. RECORD STEEL IMPORTS ARE POSSIBLE THIS YEAR, AND EVEN THESE MAY NOT SATISFY ALL CHINA'S NEEDS.

TRANSPORT
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15. SUBSTANTIAL PROGRESS IN INCREASING RAIL FREIGHT TONNAGE WAS MADE IN THE SECOND QUARTER OF 1977, BUT INCREASES SINCE THEN HAVE BEEN SLOW AND DIFFICULT. CHINESE RAILROADS STILL CONSTITUTE A LONG-TERM STRUCTURAL IMPEDIMENT TO RAPID GROWTH FROM WHICH NO RELIEF IS IN SIGHT, GIVEN THE ESTIMATE THAT HALF OF CHINA'S FREIGHT TRAFFIC IS COAL. THE REST OF THE TRANSPORT PICTURE -- INLAND WATERWAYS AND ROADS -- IS NO BRIGHTER.

AGRICULTURE

16. IT IS TOO EARLY TO COMMENT WITH CERTAINTY ON AGRICULTURAL PRODUCTION. OUR IMPRESSION, FROM TRAVELS THROUGH CHINA AND CHINESE REPORTS, IS THAT THE AUTUMN HARVEST WILL BE GOOD TO

EXCELLENT, DEPENDING ON THE REGION, AND WILL
LARGELY MAKE UP FOR THE SOMEHWAT DISAPPOINTING
SPRING HARVEST. THE WINTER-SPRING DROUGHT
APPARENTLY DID LESS DAMAGE THAN EARLIER BELIEVED
AND RAINS IN APRIL AND MAY HELPED GREATLY,
EXCEPT NEAR THE MOUTH OF THE YELLOW RIVER. IN
SUM, GRAIN PRODUCTION MAY BARELY EXCEED THE 1976
LEVEL. IN ANY CASE, WHEAT IMPORTS WILL CONTINUE
UNTIL LATE 1978, ALTHOUGH PROBABLY AT A LOWER
LEVEL THAN 1977, AND IMPORTS OF SOYBEAN OIL
AND CONNOR EVEN LONGER.

17. YU CHIU-LI'S REPORT AT THE FOURTH NPC PLENUM
STRONGLY SUGGESTS THAT THE PRC PLANS TO INCREASE
THE AMOUNT OF NATIONAL RESOURCES DEVOTED TO
AGRICULTURE. AREAS FOR IMPROVEMENT INCLUDE WATER
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CONSERVANCY, IMPROVING SEED STRAINS, GREATER
APPLICATION OF CHEMICAL FERTILIZER, AND MECHANIZATION.
THE AGGREGATE COST OF MODERN INPUTS REQUIRED BY
AGRICULTURE IS PROBABLY RISING CONSIDERABLY,
ALTHOUGH THE UNIT COSTS OF SOME OF THESE INPUTS
(E.G., CHEMICAL FERTILIZER) HAVE SHARPLY DECREASED
AS MORE EFFICIENT PLANTS COME ON STREAM.
PRODUCTION OF AGRICULTURAL MACHINERY WAS
REPORTED TO BE UP CONSIDERABLY IN THE FIRST
EIGHT MONTHS OF 1977. GROWTH CLAIMS
VARYING BETWEEN 10 TO 60 PERCENT WERE MADE
FOR 14 TYPES OF AGRICULTURAL MACHINERY, BUT
NO OVERALL CLAIM WAS MADE, AND TRACTORS, IN
PARTICULAR, HAVE HAD SERIOUS PROBLEMS.
MOREOVER, THESE CLAIMS SHOULD BE CONSIDERED
IN THE LIGHT OF EVIDENCE THAT PRODUCTION LAST
YEAR DROPPED SIGNIFICANTLY.

PROSPECTS

18. CHAIRMAN HUA PREDICTED IN THE FALL OF 1976
THAT A YEAR WOULD BE REQUIRED TO CONSOLIDATE
THE ECONOMY AND THREE YEARS WOULD BE REQUIRED
TO RESUME RAPID PROGRESS. HE HAS MADE GOOD,
ESSENTIALLY, ON THE RESTORATION OF THE ECONOMY.
ALTHOUGH THE CHINESE ECONOMY IS BACK ON THE
TRACK, THE ROAD AHEAD IS DIFFICULT. IMPROVEMENT
IN THE POLITICAL STABILITY, MORE PRECISE ECONOMIC PLANNING
(OF A SORT WHICH HAS NOT EXISTED FOR SEVERAL
YEARS) AND GOOD LUCK IN CROPS, WORLD PRICES AND
THE WORLD ECONOMY IN GENERAL.

19. OVER THE LONGER TERM, THE HUA GOVERNMENT'S
APPARENT COMMITMENT TO RATIONALIZING ENTERPRISE
MANAGEMENT, UPGRADING THE BANKING AND FINANCIAL
SYSTEM, INCREASING LABOR PRODUCTIVITY, AND
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IMPROVING THE LIVING AND WORKING CONDITIONS
OF WORKERS SHOULD CONTRIBUTE TO ECONOMIC GROWTH.
RECENT REFORMS IN EDUCATION AND SCIENCE
POLICY SHOULD ALSO CONTRIBUTE GREATLY TO
ECONOMIC PERFORMANCE, BUT THE EFFECTS WILL NOT
BE FELT FOR SEVERAL YEARS. TAKEN AS
A GROUP, THESE POLICIES JUSTIFY CAUTIOUS OPTIMISM
ON THE PROSPECTS FOR CONTINUED GRADUAL IMPROVEMENT
IN SOLVING THE STRUCTURAL PROBLEMS AND SPECIFIC
BOTTLENECKS FACING THE CHINESE ECONOMY. ACHIEVING
CHOU EN-LAI'S GOAL OF A MODERN, POWERFUL, SOCIALIST
CHINA BY THE YEAR 2000 IS POSSIBLE, BUT IT WILL
TAKE BETTER ORGANIZATION AND MORE DEDICATION TO
PRODUCTION THAN CHINA HAS SEEN FOR A DOZEN YEARS.
THE NEXT YEAR OR TWO SHOULD TELL WHETHER THE
FOUR MODERNIZATIONS ARE A FEASIBLE GOAL.
WOODCOCK

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